

IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO

DIVISION OF FINANCIAL MANAGEMENT SEPTEMBER 2005 VOLUME XXVIII NO. 3

On August 29, 2005 Hurricane Katrina slammed into the Gulf Coast, with Louisiana and Mississippi suffering the brunt of the tempest's fury. On September 8, 2005 Global Insight, one of the nation's leading economic research and forecasting firms, presented a web cast to discuss the economic impacts of Hurricane Katrina. This issue of the *Outlook* summarizes Global Insight's findings. Please keep in mind these estimates are subject to change as more information becomes available.

Natural disasters tend to have a fairly predictable effect on the economy. First, they suppress output for about one quarter. However, after the initial shock, rebuilding activities usually boost the economy. Katrina will have a deeper and more prolonged negative impact compared to other disasters for three reasons. One, New Orleans could be shut down for several months. Two, damages to the port of New Orleans could impact import and export flows. Three, the region's energy infrastructure has been severely damaged. It is anticipated the recovery from Hurricane Katrina will take longer than usual because the rebuilding phase will be delayed until floodwaters recede.

While Katrina is expected to be the most costly storm in this country's history, its impact on the overall U.S. economy will be slight. The main reason the economy should shrug off this hurricane's impacts is the economy was strong when the storm hit the Gulf Coast. Specifically, forecasted real GDP growth in 2005 has been scaled back 20 basis points to 3.5% this year. Real GDP growth

has been raised by this same amount in 2006 to 3.4%.

The economy has already been impacted by the damage to the energy infrastructure. Hurricane Katrina knocked out 10% of the nation's petroleum refining capacity. The storm damage sent the retail price of unleaded gasoline above \$3 per gallon overnight. The Hurricane also reduced both U.S. crude oil and natural gas production by nearly 20%. The good news is these losses are expected to be reversed fairly quickly. For example, Global Insight believes 60% of the lost refining capacity will be back on line two weeks after the storm hit, and in two months 90% of the capacity will be restored. As a result, the price of unleaded gasoline should decline to \$2.50 per gallon by the end of 2005. The bad news is the upside risks to the energy forecast has increased. For example, the price of oil could go as high as \$80 per barrel by the end of this year and the price of natural gas could rise another 25%. Fears that Hurricane Rita would further disrupt the region's already hindered energy industry raised the price of oil by over \$4 per barrel on September 19, 2005—its highest one-day increase.

Economists predicted consumer spending would slow even before the hurricane season started. The higher gasoline prices and heating bills will exacerbate the expected spending slowdown by acting as additional taxes on disposable income. In addition, the stream of images from New Orleans and surrounding areas has shaken consumer confidence. Job losses will also hurt spending. As a result, real consumer spending is now

expected to grow slightly slower over the next three quarters than had been previously projected.

Hurricane Katrina will impact the federal deficit. Up until the time the hurricane made landfall, it appeared the U.S. unified federal budget deficit would shrink from \$413 billion in FY 2004 to \$326 billion in FY 2005 and fall to just below \$300 billion in FY 2006. It is assumed federal government outlays will increase \$100 billion because of the hurricane over several fiscal years. As a result, the unified federal budget deficit is \$338 billion in FY 2005 and is expected to rise to \$343 billion in FY 2006. However, one should remember Hurricane Katrina has delayed, but not stopped, improvements to the deficit. Barring any further surprises, the U.S. unified federal budget deficit should begin to shrink again beginning in FY 2007.

Idaho should feel little economic fallout from the storm. As with the rest of the country, Idahoans have felt the sting of higher fuel prices. Besides its effects on consumers, higher energy prices would raise agricultural producers' input prices and dampen tourism traffic through the state. Although energy prices are expected to retreat over the next few months, they will be high compared to their year-ago levels. Lumber and wood prices could move upwards as rebuilding boosts demand, but this is not expected to significantly raise local employment. The impacts of Hurricane Katrina will be included in the October 2005 *Idaho Economic Forecast*.

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General Fund Update

As of August 31, 2005

<u>Revenue Source</u>	<u>\$ Millions</u>		
	<u>FY06 Executive Estimate³</u>	<u>DFM Predicted to Date</u>	<u>Actual Accrued to Date</u>
Individual Income tax	1,089.9	153.1	154.6
Corporate Income tax	155.8	11.2	10.8
Sales Tax	827.8	162.0	171.9
Product Taxes ¹	23.1	4.1	4.1
Miscellaneous	107.1	14.4	13.4
TOTAL GENERAL FUND²	2,203.7	344.8	354.9

1 Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
2 May not total due to rounding
3 Revised Estimate as of August 2005

Fiscal Year 2006 General Fund revenue took another positive bounce in August, going from \$4.8 million ahead of expectations at the end of July to \$10.1 million ahead of expectations at the end of August. Virtually the entire gain can be attributed to the sales tax, which is in turn attributable to the incredibly strong real estate boom in Idaho (and the nation). The sales tax was \$6.0 million higher than expected for the month of August, and now stands \$9.9 million ahead of expectations for the fiscal year to date.

Individual income tax revenue was \$0.7 million higher than expected in August, and is ahead \$1.5 million on a year-to-date basis. This is within 1% of the predicted amount. On the collection side, filing payments were \$1.1 million higher than predicted and withholding collections were \$0.6 million higher than predicted in

August. On the payout side, refunds were \$1.2 million higher than expected and miscellaneous diversions were \$0.2 million lower than expected in August.

Corporate income tax revenue was \$1.6 million lower than expected in August, and is \$0.4 million lower than expected on a year-to-date basis. Filing payments were \$0.9 million higher than predicted for the month (primarily due to large Multistate Tax Commission collections), while quarterly estimated payments were \$2.8 million lower than predicted. Refund payments were \$1.3 million lower than expected for the month, while miscellaneous diversions were \$1.0 million higher than expected (also due to the large Multistate Tax Commission collections).

Sales tax revenue was \$6.0 million higher than expected in August.

This reflects July sales activity, and is heavily impacted by Idaho's strong construction sector. Idaho construction employment growth accelerated from 14.6% year-over-year growth in June to 16.3% growth in July. Normalized sales tax gross collections growth accelerated from 8.9% in July to 12.9% in August. Idaho auto sales also contributed to the sales tax strength, going from 10.8% growth in June to 13.7% in July. Nationally, auto sales dropped dramatically in August, but real estate activity remains strong.

Product taxes were on target in August, while miscellaneous revenue was essentially on target (\$0.1 million higher than expected for the month).